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S E C R E T SECTION 01 OF 03 BRASILIA 002150

SIPDIS

TREASURY FOR PARODI, STATE PASS TO USTR AND TO USAID/LAC/AA

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TAGS: [PGOV](#) [PREL](#) [ECON](#) [BR](#)

SUBJECT: BRAZIL CORRUPTION SCANDAL UPDATE, WEEK OF 8-12 AUGUST 2005

REF: A. BRASILIA 2082

[B](#). BRASILIA 1979

[C](#). BRASILIA 1874

[D](#). BRASILIA 1973

[E](#). BRASILIA 1631

[F](#). BRASILIA 2025

[G](#). (S/NF) TD 314/47956-05 9 AUG 05

Classified By: POLITICAL COUNSELOR DENNIS HEARNE. REASONS: 1.4 (B)(D).

[1](#)1. (SBU) SUMMARY. In one of the most dramatic moments thus far in the continuing corruption scandals (refs a-f) plaguing the Brazilian government, President Lula da Silva's 2002 campaign publicity coordinator Duda Mendonca stated on 12 August before the Postal Service CPI that the Workers' Party (PT) paid for his services through deposits to an offshore account in transactions managed by advertising executive and money man Marcos Valerio. Such transactions would constitute violations of Brazilian tax laws, and would expose Lula himself more directly to guilt by association with Valerio's improprieties. This development, coming atop the already broadening dimension of the crisis, led some opposition figures to openly discuss impeachment. On 12 August Lula read a brief statement on television in which he denied any wrongdoing, pledged continued investigation by federal authorities and punishment of all guilty parties, and apologized to the nation for the current state of affairs.

[1](#)2. (SBU) Summary continued. Earlier in the week, Valerio testified before the Congressional Inquiry Committee (CPI) on vote buying that former Presidential Chief-of-Staff Jose Dirceu had authorized loans to the PT, and that former Communications Minister Luiz Gushiken was also aware of the loans to the Party. Valerio presented a list with the names of 79 persons, the majority from the opposition party PSDB, who had withdrawn money from his accounts. Also this week, eight impeachment requests against congressmen allegedly involved in the PT bribes-for-votes scheme were sent to the Ethics Committee. And bank records sent by the PT to the Brazilian Electoral Court revealed that four deposits had allegedly been made by President Lula into PT accounts in 2003-4. The President denied having used loaned party funds for personal expenses and others affirmed that the President was unaware of the payments. END SUMMARY.

LULA'S PUBLICIST DEEPENS THE CRISIS...

[1](#)3. (U) On 11 August, Duda Mendonca, Brazil's most famous political consultant and the media architect of Lula's successful 2002 presidential campaign, delivered a voluntary testimony before the Postal Service CPI, and deepened the current political crisis by stating that he received illegal, undeclared funding from accused PT money broker Marcos Valerio via deposits into an offshore account. According to Mendonca, the money was used to pay the Workers' Party (PT) costs for the 2002 campaign in which Lula won the presidency. Such transactions would constitute violations of Brazilian financial and tax laws. The statement shocked PT congressmen in the hearing, who wept in indignation during Mendonca's testimony and joined the opposition in demanding that Lula address the nation to explain his involvement in a widening scandal, which now is moving beyond irregular campaign funding already acknowledged by the PT and the vote-buying scheme that is widely alleged (refs) and into the sphere of tax evasion and possible financial crimes. Senior opposition figures, in the wake of the 11 August testimony, openly discussed whether the time is near for initiating impeachment proceedings against the President.

...AND LULA SPEAKS OUT

[1](#)4. (U) In response to the dramatic Mendonca testimony, and after weeks of calls for a presidential address to the nation, Lula made a brief televised statement on 12 August. Speaking calmly and forcefully, against the backdrop of a meeting of his cabinet in the Planalto Palace, Lula denied any personal wrongdoing, pledged commitment to thorough ongoing investigations by authorities of all allegations, promised continuation of fiscal policies and economic growth, called for political reforms, and apologized to the Brazilian

people for the "indignities" of the current situation.

#### VALERIO'S SECOND TESTIMONY BEFORE CONGRESS

15. (U) Earlier in the week, on 9 August, Marcos Valerio testified before the vote-buying scheme CPI that former Chief-of-Staff Jose Dirceu had authorized more than \$24 million in loans to the Workers' Party (PT). Valerio stated that Dirceu "was a powerful and arrogant minister. He is no one's friend . . . Today, I consider him my enemy." Valerio also maintained that Luiz Gushiken, former Communications Minister and current chief of the Presidency's Center for Strategic Studies, was aware of the loans to the PT as well as the money the PT gave to other parties. In his 14-hour testimony, Valerio also stated that more than \$6 million was given to advertising executive Duda Mendonca. Valerio made it a point though to emphasize Lula's innocence, stating that he could not say that Lula had knowledge of the illicit transactions. Valerio presented a list with the names of 79 persons, the majority from the opposition party PSDB, who had withdrawn more than \$783,000 from his accounts for the 1998 Minas Gerais state campaign. Late in the testimony, a row in the committee broke out when a PT congressman attempted to add into the record a second list of 128 names of mainly PSDB allegedly involved in the 1998 Minas actions, which was procured in dubious circumstances. The list was widely discredited as false, with some in the PSDB accusing Dirceu and others of planting the document to divert attention from the PT acts as the center of the scandals. The PT congressman, Paulo Pimenta, resigned his position from the CPI on 11 August.

#### CHAMBER MAY IMPEACH OVER TWENTY CONGRESSMEN

16. (U) On 10 August, Speaker of the House Severino Cavalcanti yielded to pressure from opposition leaders and forwarded to the Ethics Committee eight impeachment requests against congressmen allegedly involved in the PT bribes-for-votes scheme, including the complaint against Jose Dirceu (PT), Lula's former chief of staff. Besides Dirceu, five members of Roberto Jefferson's PTB party, one member of the Brazil's vice-president's PL party, and one of the PRB party will be investigated for violating congressional decorum and, if found guilty, may be impeached and lose political rights for 8 years. In addition, the Ethics Committee may open investigations on another 13 congressmen, mostly from the PT and PP parties, also for violating congressional decorum. These congressmen can resign before investigations begin in order to retain political rights, as did the former PL president Valdemar Costa Neto who renounced his chamber seat on August 1. PT president Tarso Genro had previously stated that any member who resigned would be expelled from the party. However, Dirceu publicly confronted Genro, disagreeing with his decision and further dividing the party, just weeks before its internal elections.

Congressmen under investigation -- cannot resign:

- Roberto Jefferson (PTB)
- Jose Dirceu (PT)
- Romeu Queiroz (PTB)
- Sandro Matos (PTB)
- Joaquim Francisco (PTB)
- Neuton Lima (PTB)
- Francisco Goncalves (PTB)
- Sandro Mabel (PL)
- Alex Canziani (PRB)

Congressmen under suspicion ) have the option of resigning to retain political rights:

- Joo Paulo Cunha (PT): former President of the Chamber of Deputies
- Paulo Rocha (PT)
- Professor Luizinho (PT)
- Joao Magno (PT)
- Josias Gomes (PT)
- Jose Mentor (PT)
- Jose Janene (PT)
- Pedro Correa (PP)
- Pedro Henry (PP)
- Vadao Gomes (PP)
- Carlos "Bispo" Rodrigues (PL)
- Wanderval dos Santos (PL)
- Jose Borba (PMDB)

LULA'S LOANS FROM PT?

17. (U) An examination of bank records sent by the PT to the Brazilian Electoral Court revealed that four deposits had allegedly been made by President Lula into PT accounts, totaling \$12 million in 2003-4. According to the party, the deposits were intended to settle Lula's debts with the PT. The President denied having used loaned party money, and Minister of Political Articulation Jacques Wagner and PT floor leader Senator Aloisio Mercadante said that this loan

never existed, that the PT treasury had committed an error by noting this "loan" in the President's name. On 9 August, Paulo Okamoto, the PT's treasurer in Lula's 1989 presidential campaign currently heading the Small Business Administration (Sebrae), stated that he had made the deposits in the President's name, but did not show any receipts, and affirmed that the President was unaware of the payment. It would be illegal to use PT formal funds -- which are in part public moneys provided under Brazilian electoral programs to all registered political parties -- for personal expenses.

COMMENT  
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18. (S/NF) Duda Mendonca's testimony appears to directly link Lula's campaign with illegal off-shore financial activity run by Marcos Valerio, the money man at the center of the ongoing scandal. In itself, this is a grave development for Lula in terms of his personal vulnerability. But it comes at a time when weeks of revelations and testimony (refs a-f) have already established a body of compelling circumstantial evidence of impropriety on such an enormous scale that it is becoming impossible for the congress, media and public to avoid intense questions about Lula's broad responsibility -- whatever his proven level of awareness -- for the crisis engulfing Brazilian political life. In this context, open if reluctant discussion of the possibility of impeachment -- a path most Brazilians still view with weary dread -- is increasing. There is a growing sense that matters must now move through investigation toward an end point of meaningful consequences, or risk dissolution into a farce that could damage the credibility of the country's institutions, which have generally functioned well in the crisis thus far. At this point, additional substantial revelations of serious impropriety -- especially if linked directly to Lula -- would be devastating. We believe such revelations may emerge (ref g). In septels to follow, we will assess political aspects of scenarios of either an impeachment or a discredited Lula limping through the balance of his term. A septel being transmitted concurrently with this message analyzes economic dimensions of those scenarios.

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